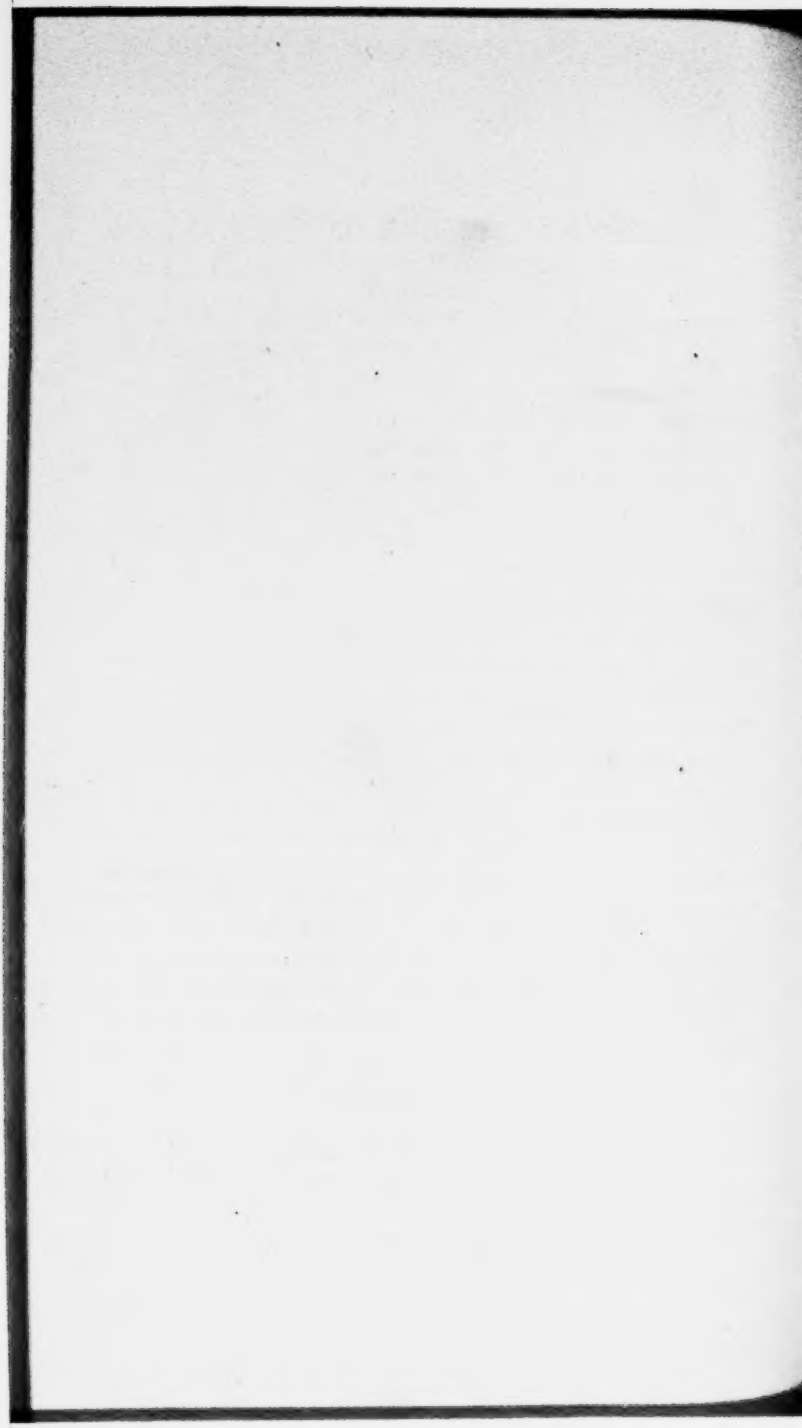

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Supreme Court of the United States

OCTOBER TERM, 1903.

No. 632
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THE GREAT WESTERN MINING AND MANUFACTURING COMPANY, by L. C. BLACK, Receiver,

Petitioner,

against

CHARLES A. HARRIS et al., Executors, &c., of B. D. HARRIS,

Respondents.

Brief in Opposition to Petition for Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit.

JULIEN T. DAVIES,
BRAINARD TOLLES,
Of Counsel for Respondents.

IN THE

Supreme Court of the United States.

THE GREAT WESTERN MINING AND MANUFACTURING COMPANY, by L. C. BLACK, Receiver,
Petitioner,

vs.

CHARLES A. HARRIS *et al.*, Executors, &c., of B. D. HARRIS,
Respondents.

October Term, 1903.

No.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

The strength of the petition consists wholly in the erroneous statement of what the Circuit Court of Appeals decided. A reference to the actual decision of that court upon the several matters mentioned in the petition will show that the judgment which the petitioner seeks to have brought into this court for review was the only judgment that could have been rendered, consistently with legal principles established by repeated decisions of this court.

We shall take up the several points of the decision, not in the precise order in which they are presented in the opinion of the Circuit Court of Appeals, but in the order in which they naturally present themselves in connection with the chain of events which led up to the litigation.

I.

THE DISTRIBUTION AMONG THE STOCKHOLDERS OF $100,000 OF ADDITIONAL FULL-PAID STOCK, WITHOUT CONSIDERATION, WAS A TRANSACTION BINDING ON THE CORPORATION AND IMPEACHABLE ONLY BY SUBSEQUENT CREDITORS. AFTER THE INCREASE EACH STOCKHOLDER HAD A GOOD TITLE TO ALL HIS STOCK AS AGAINST THE CORPORATION.

The bill alleges and the proof shows that in 1889 the Great Western Mining and Manufacturing Company, having a capital stock of $250,000, issued $100,000 of additional stock as full paid, and divided the same among its stockholders *pro rata*, without receiving any consideration therefor.

The ostensible reason for the increase, recited in the resolutions, was that permanent improvements to that extent had been made out of earnings. The real reason was to facilitate a division of the stockholders' interest, so that they could dispose of three-sevenths of their equity without introducing inconvenient fractions.

The effect of the transaction was not to increase or diminish the gross assets or the net assets of the corporation, or to change the relative interest in the corporation of any stockholder. The sole effect was to change the manner in which those relative interests were represented, so as to make the same more readily divisible and alienable.

Regarding this transaction the Circuit Court of Appeals said:

> "It would seem that, inasmuch as it was agreed as part of the contract between the corporation and its stockholders that the stock

should be deemed full paid, the stockholder could not be held liable in a suit by the corporation wherein it seeks to annul its contract as a fraud upon the general creditors of the corporation."

Citing:

Hale *vs.* Allinson, 188 U. S., 56.
Coit *vs.* Gold Amalgamating Co., 119 U. S., 343.
Handley *vs.* Stutz, 139 U. S., 417.
Clark *vs.* Bever, 139 U. S., 96.

These decisions are conclusive as to the merits of the case, because they establish the proposition that, notwithstanding the change in the manner in which the stockholders' interests were represented, all the shares of stock, and the proceeds of every share, to the utmost limit to which such proceeds can be traced, were and are the private property of the several shareholders.

II.

THE AGREEMENT BETWEEN THE CORPORATION AND B. D. HARRIS TO SELL CERTAIN PROPERTY OWNED BY THEM IN SEVERALTY, THROUGH A JOINT AGENT, AND TO DIVIDE THE PROCEEDS ON AN AGREED BASIS, WAS A BINDING AND VALID AGREEMENT.

Mr. Harris, in 1889, after the increase last spoken of, was the owner of 1,050 shares of stock of a certain corporation. His title was full and perfect, free from any trust. He had a right to sell them, or any of them, to whom he chose, for such price as he was willing to accept and to apply the entire proceeds to his own use.

The Great Western Mining and Manufacturing Company was at the same time the owner of certain bonds of the same corporation. Its title to these bonds was as good as its title to any other part of its corporate property. It had a right to sell them, or any of them, to whom it chose, for such price as it was willing to accept and to apply the entire proceeds to its corporate purposes.

These several owners became aware that, through some peculiarity of the market for mining securities, the stocks and bonds which they respectively owned and were willing to sell would bring a better price if offered in combination than they would if offered separately. They might have sold their respective holdings to an intermediary who, by combining and readjusting his purchases in a manner more acceptable to the market, might have resold at a profit. In that case no one would think of claiming, as between Harris and the Mining Company, that either had any claim on the consideration received by the other for property over which, in each case, the vendor had the exclusive right of ownership.

Instead of permitting a broker to make a middleman's profit, they agreed to place what they were willing to sell in the hands of a joint agent, to be disposed of for a joint consideration, in the form which the requirements of the market rendered appropriate. They agreed also to divide the consideration on a basis of relative values, the fairness of which is not impeached.

It is true that the stock and bonds which were the subject of this arrangement were stock and bonds of the Great Western Mining and Manufacturing Company. But this, we conceive, does not affect the inherent nature

of the transaction. The equities of the situation were the same, no matter what name was engraved on the certificates.

The Circuit Court of Appeals held that this arrangement was entered into by B. D. Harris in good faith, and that no circumstances of fraud or deception in carrying it out were either alleged or proved. The Court said:

> "Neither the bill filed in the Kentucky Court nor the bill herein charges that any purchaser of bonds or stocks was deceived by said action of the corporation and there is no evidence to that effect."

And again:

> "So far as this defendant's testator is concerned, while there are some expressions in his letters which are capable of being interpreted as evidence of an intent to secure a benefit to himself as stockholder at the expense of the corporation, yet the evidence taken as a whole falls far short of proving that he was a party to any unlawful scheme or believed that the plan which was adopted for floating the bonds and selling his stock was either actively or constructively fraudulent."

The learned Court inadvertently attributed to B. D. Harris certain letters which were not written by him, but by John Carlisle. Mr. Harris' own letters contain the most positive evidence of good faith (Exhibit 98, particularly at pp. 106–111). See, also, the testimony of John Carlisle (Rec., 155).

The ruling which the petitioner apparently expects this Court to make upon these facts is that by receiving from the joint agent the agreed proportion of the joint consideration, B. D. Harris unlawfully took property of the corporation. We might contend, with equal plausibility, that the corporation, by receiving its agreed proportion of the consideration from the joint agent, unlawfully took the property of B. D. Harris.

The petitioner ignores the fact that Harris parted with three-sevenths of his stock interest; that the interest so parted with had a substantial present market value; that the enterprise was a mining venture, involving large and unknown possibilities of loss and gain; that Carlisle handled the stock and bonds and divided the proceeds as a joint agent appointed by express agreement; that the basis of division was fair and equitable; that the transaction was assented to by the predecessors in title of all the existing stockholders, and that no creditor has been heard to complain of it. Brushing aside all these circumstances, which would discourage an ordinary complainant, he attempts to create a cause of action by the plentiful use of italics and invective.

Apparently, if Mr. Harris had parted with his entire interest in the corporation, instead of three-sevenths, the petitioner would be equally ready to claim that the entire proceeds should have gone into the treasury of the corporation.

What the learned Circuit Court of Appeals really held in regard to this claim was not, as stated in the petition, "that no cause of action was vested in the corporation to recover $75,000 of funds of the company, which the directors and officers had secretly and fraudulently abstracted." On the contrary, its ruling is more fairly expressed in the following words, quoted with approval from the opinion of Judge WHEELER. Speaking of shares of stock which belonged to stockholders in their individual right, the learned Judge said:

> "If sold to others, whether it was valuable or not, or at a fair or unfair price, the corporation would not be pecuniarily affected. If it brought 25 cents of the 85 cents on the dollar of the face of the bonds

that the stock and bonds brought, that part would belong to the stockholder furnishing the stock, and not to the corporation; and the receiving of that by the stockholders would not be depleting the assets of the corporation. The bonds would not float at 60. The bonds and stock would at 85. The inference follows that the bonds brought 60 and the stock 25.

The stockholders and directors agreed to this among themselves, each with the others, and that would confirm the division, for, although directors may not contract away to any of themselves more than to others the property of the corporation to the detriment of creditors, they are not precluded from dealing fairly with any of their number in respect to what is his own."

These words were originally used by Judge WHEELER as applying only to a part of the stock, but the Circuit Court of Appeals applied them to all of the stock, holding that all of it was the individual property of the shareholders.

The distinction which Judge WHEELER supposed to exist between the several issues of stock was clearly shown by the Circuit Court of Appeals to be without any rational basis, and the present petitioner does not contend that any such distinction is possible.

III.

THE "FRAUD" WHICH THE PETITIONER ASSUMES WAS COMMITTED ON PURCHASERS OF THE BONDS AND STOCK, IS NOT ALLEGED IN THE BILL NOR ESTABLISHED BY EVIDENCE. THE CORPORATION IS NOT A PROPER PARTY COMPLAINANT TO ASSERT A GRIEVANCE OF THAT KIND.

In order to appreciate the petitioner's argument in regard to the alleged "fraud" it is necessary to understand the status of Elliott, Johnson & Co. in this case. That firm is mentioned twenty-four times in the petition,

while the Court which appointed the receiver is mentioned only twice. It is nevertheless true that in a legal sense the firm of Elliott, Johnson & Co. has no relation to the cause of action.

Elliott, Johnson & Co. are not parties to the suit; they are not mentioned in the bill, nor are they shown to have any legal interest in the corporation. They were merely brokers. They assumed no responsibility (Exhibit 16, p. 36). They bought neither bonds nor stock, nor did they agree to buy any, nor did they guarantee the sale of any (Exhibit 18, p. 37). Their legal status was quite accurately described in the complainant's brief in the Circuit Court of Appeals (p. 107), where he said: "Elliott, Johnson & Co. have nothing to do with this suit."

Of course, if actual purchasers of bonds and stocks were told that the entire amount which they paid was to go into the treasury of the corporation, when in fact a part of the consideration was to go to Elliott, Johnson & Co. and a part to the stockholders whose stock was sold, that would be a fraud. There is no such allegation of fact in the bill, nor is there a word of proof to that effect in the record. It is extremely unlikely that any statement was made to purchasers as to the disposition to be made of the money received. The Court may take judicial knowledge of the well-known fact that such issues of bonds and stock are ordinarily underwritten, and offered to the public for the benefit of the underwriters. Purchasers do not expect to be told how much of the consideration paid enures to the benefit of the corporation. In this case Elliott, Johnson & Co. took all the profits of underwriters

without assuming the risks and responsibilities of such a position (Exhibits 16, 18, pp. 36, 37; Exhibit 114, p. 231). It is not to be supposed that they divulged this state of affairs to their customers.

Upon this feature of the case the rulings of the Circuit Court of Appeals were:

> "This suit cannot be treated as one brought to annul the contract whereby said transaction was carried out by creditors who may have been defrauded thereby. Neither the bill filed in the Kentucky court nor the bill herein charges that any purchaser of bonds or stocks was deceived by said action of the corporation, and there is no evidence to that effect."

And again:

> "It may be that the acts and misrepresentations of Carlisle, the manager of said corporation, or of the brokers through whom the bond transaction was carried out, were in fraud of persons who became creditors upon the strength of such representations, and that an appropriate suit may be brought by such creditors to recover therefor. * * * The complainant is bound by the allegations of the bill, and the contention on which it is based, that this is a suit only in the right of the corporation, independent of its creditors, and to which neither the receiver nor the creditors are parties. We are clear that such a suit cannot be maintained by this corporation. * * * It is clear that it is not the proper party to maintain this suit."

Citing

Foster *vs.* Seymour, 23 Fed. Rep., 65.

Flagler Engraving Machine Co. *vs.* Flagler, 19 Fed. Rep., 468.

To which we take the liberty of adding, as bearing on the possibility of a corporation's founding a cause of action on frauds committed by its own members through the use of its own corporate machinery,

Tompkins *vs.* Sperry, Jones & Co., 96 Md., 560.

In re Ambrose Lake, &c., Mining Co., L. R., 14 Ch. D., 390.

IV.

It appears on the face of the bill that the Great Western Mining and Manufacturing Company is not the real complainant.

From the caption of the bill, the manner in which it was signed and the allegations contained in it, the Circuit Court of Appeals inferred that the moving party in the prosecution of the suit was L. C. Black, Receiver, and not the corporation, which appears as a nominal complainant. That inference is confirmed by the present petition, which plainly states (p. 2) that the suit is brought by L. C. Black, Receiver, "*in the name of the Great Western Mining & Mfg. Co.*" The suit does not purport to be brought by virtue of any authority or title derived directly from the Great Western Mining and Manufacturing Company, but solely by authority of an order of the Circuit Court of the United States for the District of Kentucky (Exhibit 109, p. 198). That order did not in terms authorize the receiver to bring suit outside the territorial jurisdiction of the court which appointed him. The learned Circuit Court of Appeals has held that no such authority can be implied, because it was not within the power of the Circuit Court of the United States for the District of Kentucky to send its officers into the District of Vermont to collect and administer assets of the insolvent corporation having a situs in said district.

This receiver was appointed by a court of equity in the exercise of its general chancery powers. He is a mere arm of the court; he has no title to anything except the name and office of a receiver. There was nothing in the charter

of the corporation which contemplated the exercise of its corporate powers by a court of equity. The corporate "name" was not one of the assets over which the Court had jurisdiction.

The petitioner recognizes the rule which prevented him from exercising his official powers outside the territorial jurisdiction of the court which appointed him. But he makes the mistake of supposing that this was a mere rule of procedure, which could be evaded by a slight change in the form of the bill. In reality, the limitation is inherent in the powers of the court which appointed the receiver. That court cannot enlarge its functions or increase its powers by devising new methods of procedure.

It was said by this Court in *Booth* vs. *Clark*, 17 How., 338, in regard to a receiver of this kind:

> "He has no extra-territorial power of official action; none which the Court appointing him can confer, with authority to enable him to go into a foreign jurisdiction to take possession of the debtor's property; none which can give him, upon the principle of comity, a privilege to sue in a foreign court or another jurisdiction, as the judgment creditor himself might have done, where his debtor may be amenable to the tribunal which the creditor may seek."

Regarding this statement of the law as it existed in 1854, this Court has recently said:

> "This statement has not been overruled or explained away by any subsequent decision of this Court to which our attention has been called."
>
> Hale *vs.* Allinson, 188 U. S., 56, 68.

These decisions do not place the incapacity of the receiver to sue in a foreign jurisdiction upon the ground that the order of the Court directing such action was not sufficiently explicit. They place it on the ground of a

lack of power in the Court making the appointment. Clearly, if that Court cannot confer such power by direct and express command, it is equally powerless to accomplish substantially the same result by slightly varying its phraseology.

Upon this point the ruling of the learned Circuit Court of Appeals was not, as stated in the petition, that the Circuit Court for the district of Vermont had no jurisdiction of the suit. The ruling actually made is more correctly expressed in the language of the learned Court itself, as follows:

> "But if said Court cannot send such an agent outside of its territorial limits to collect moneys as receiver, its attempt to exercise extra-territorial powers by directing such agent to proceed in the name of the corporation, must be equally futile except where the Court by statute or otherwise is empowered to vest title in the receiver, or where the corporation or the Court, acting within its powers on behalf of the corporation or as the successor of its officers, has authorized such act."

The exception last referred to was doubtless thought necessary in view of the statutes of those states which, in creating corporations, provide for the exercise of corporate powers, in certain contingencies, by a court of equity or through the instrumentality of a receiver. (See the New Jersey Act concerning Corporations [Revision of 1896], Section 68.) When such a provision exists in the charter and consequently becomes part of every contract made by or with the corporation, a question arises which is different from that presented by the appointment of an ordinary chancery receiver. It is not claimed that any such statute exists in Kentucky.

It is respectfully submitted that the point which the petitioner seeks to raise is not a mere question of

the form of procedure. It is a question of the power of the Circuit Court for the District of Kentucky to draw to itself by legal process the administration of assets not within the territorial limits of its jurisdiction. That question has been so recently passed upon by this Court and decided in such unmistakable terms that it does not require reconsideration.

The question is not necessarily involved in this case, because the Circuit Court of Appeals, waiving the objection to the complainant's capacity to sue, has passed on the merits of his claim. Neither is the question directly presented, because the order authorizing the receiver to sue did not expressly authorize him to bring suit outside of Kentucky. In *Hilliker* vs. *Hale*, 117 Fed. Rep., 220, the question was directly presented, because the receiver in that case had been expressly commanded to institute and prosecute actions in foreign jurisdictions.

This Court declined to issue a writ of certiorari in *Hilliker* vs. *Hale* (188 U. S., 739). No reason exists for pursuing a different course in regard to the present petition.

V.

THE CASES RELIED ON BY THE PETITIONER HAVE NO APPLICATION TO THE FACTS OF THE CASE AT BAR.

London Trust Company, Limited, vs. *Mackenzie*, 68 Law Times (N. S.), 380, differs from the case at bar in many particulars, among which we would call attention to the following:

(1) The original transaction was not an honest one as between the directors and the Barbados Water Supply Com-

pany. It was not a case where stockholders submitted to a diminution of their relative interest in a going concern, in consideration of receiving a part of the price obtained upon the transfer of that interest to others.

On the contrary, it was the case of an out-and-out gift of debentures and stock, unequally distributed, so that the directors got the largest shares. Any dissenting stockholder could have had an injunction to stop it. It was defended only on the alleged ground that all persons who were at the time interested in the company had knowledge of it and approved it. The Court said (p. 384):

> "The directors gave away the company's money to pay in full a debt which did not exist, and there was not any compromise."

In the case at bar the transaction between Harris and the corporation was one of which no dissenting stockholder could have complained, provided the gross consideration received was equitably apportioned. Harris got only the fair value of what he gave up, which was three-sevenths of his proportionate interest in the corporation. He could have compelled the corporation either to give back his stock or to pay him his agreed share of the gross price, and no court would have denied him relief.

(2) In the Barbados Water Supply case it was not true in point of fact that all persons interested in the company had kn[illegible]edge of the transaction and approved it. The Court said (p. 385):

> "No doubt most of the holders of shares or debentures existing at the date of the agreements had more or less knowledge of the general purpose of the scheme, but it is not proved that all had such knowledge. No circular explaining the matter was issued, nor was any general meeting called, nor does a mere general knowlege of and assent to the principles of the scheme involve knowledge of the benefit which the directors were to take."

(3) The Barbados Water Supply Company was allowed to disaffirm the transaction because it was *ultra vires* and because the directors took a secret and disproportionate benefit thereunder. Neither of these grounds is alleged to exist in the case at bar.

(4) The Court held that the corporation might disaffirm the transaction in the interest of the future holders of shares in its treasury which had never been issued, but which it was intended to issue to the public for cash. There are no such shares in the treasury of the Great Western Mining and Manufacturing Company.

(5) In so far as the case holds that a transaction of the kind above described can be impeached by a stockholder who gets his stock by purchase from one of the parties to the transaction, it stands alone among the English decisions and is contrary to the uniform current of authority in this country and to the principle of equity expressed in the 94th rule of this Court.

Foster *vs.* Seymour, 23 Fed. Rep., 65.

Venner *vs.* Atchison, &c., R. Co., 28 Fed. Rep.,581. 591.

United Elect. Securities Co. *vs.* Louisiana Elect. Light Co., 68 Fed. Rep., 673, 675.

Symmes *vs.* Union Trust Co., 60 Fed. Rep., 830.

Wood *vs.* Corry, &c., Co., 44 Fed. Rep., 146.

Flagler, &c., Co. *vs.* Flagler, 19 Fed. Rep., 468.

Re Syracuse, &c., R. Co., 91 N. Y., 1.

Kent *vs.* Quicksilver Mining Co., 78 N. Y., 186, 188.

Barr *vs.* N. Y., &c., R. Co., 125 N. Y., 263, 273.

Hollins *vs.* St. Paul, &c., R. Co., 9 N. Y. Supp., 909.

Parsons *vs.* Hayes, 14 Abb., N. C., 419, 433.

Nott *vs.* Clews, 14 Abb., N. C., 437.

Drake *vs.* New York Suburban Water Co., 26 App. Div., 499.

Cook on Corporations (5th ed'n), §§ 40, 730.

Hayward vs. *Leeson*, 176 Mass., 310, and the other cases which follow it in the course of the petitioner's argument involve the question of the duty of promoters and directors towards future holders of the unissued stock of the corporation. These cases are irrelevant because the Great Western Mining and Manufacturing Company at the time of the transaction in question was not inviting the public to subscribe to its stock and it is not now likely that it will ever extend such an invitation.

The petitioner quotes the words "future stockholders" from these decisions as though they meant the successors in interest of the existing stockholders. What the phrase really means in this connection is, holders of stock that is to be issued in the future. All these decisions hold (and none more clearly than *Hayward* vs. *Leeson*) that after the stock which is intended to be offered to the public has been fully subscribed, then by unanimous consent of all the subscribers the promoters may receive any profit that may be agreed upon. This implies a power in the registered stockholders, *at that time*, to bind their successors in interest by such consent. If each stockholder gets this power as soon as the stock is

fully issued, there is no reason why he should not retain it so long as he continues to be a stockholder.

In *Hayward* vs. *Leeson* the Court puts this matter very plainly at page 320:

> "The persons to whom the the promoters owe the duty which they owe by reason of their fiduciary relation are the persons who put their money into the enterprise at the invitation of the promoters, that is to say, the future stockholders."

A man who buys stock from an existing stockholder has no reason to believe and of course does not believe that he is "putting money into the enterprise." He knows perfectly well that he is putting money into the pocket of the man from whom he bought the stock. A man who buys stock without asking or knowing from whom he buys it, certainly cannot complain of deception whether it turns out that the purchase is made from a former holder of the shares or from the company itself.

It would be most absurd to imagine a fiduciary relation between each stockholder and all his successors in title. That would mean that a stockholder must always be guilty of a breach of trust if he waives any part of his strict legal right by consenting to anything from which he could possibly dissent. A corporation conducted on that principle would not be likely to weather many financial storms.

The relation which a stockholder occupies toward one to whom he sells stock is not a fiduciary relation, but the ordinary relation of vendor and purchaser. Both relations require good faith and both exclude fraud. Here the resemblance ceases and no good purpose is to be served by confusing relations that are essentially distinct.

The petitioner calls attention to the fact that in *Hayward* vs. *Leeson* the Court gave leave to substitute the East Tennessee Land Company as plaintiff, in place of the receiver. From this the petitioner infers that the Court intended to sanction a continuation of the suit by the receiver in the name of the corporation, without any other authority than that given by the order of the Court which appointed him. We do not so understand the judgment. In holding that the East Tennessee Land Company had title to the cause of action sued upon and in requiring it to be substituted as plaintiff, the Court clearly required that it should become the real complainant, should control the suit and receive the proceeds, subject to the power of any court of competent jurisdiction to which application might be made in the meantime to provide for the custody and administration of such proceeds by an ancillary receivership. The petitioner has no warrant for assuming that the Court would have been satisfied with an evasive compliance with its decree. What the judgment manifestly required was that the real owner of the cause of action should make an actual appearance in the suit, so that the Court should have jurisdiction over it, *in personam*.

VI.

MANY STRONG REASONS EXIST FOR SUSTAINING THE JUDGMENT WHICH ARE NOT REFERRED TO IN THE OPINION OF THE CIRCUIT COURT OF APPEALS. WITHOUT DISCUSSING THESE WE SUBMIT THAT, FOR THE REASONS WHICH APPEAR ON THE FACE OF THE OPINION, THE JUDGMENT IS MANIFESTLY RIGHT AND THE PRAYER OF THE PETITION SHOULD BE DENIED.

Dated April 4, 1904.

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